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India's problem is not politics

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Abstract:

India's elections aroused fears about its political viability but elicited yawns about its economic health. The reality of India's prospects is just the opposite. Conventional wisdom aside, the main threat India faces is economic. Slower growth and a stalled program of economic reforms could endanger India's stability. Its politics, by contrast, exhibit an admirable ability to bring extremists, including the Hindu nationalists of the newly preeminent Bharatiya Janata Party, closer to the center. India's democracy is the glue that keeps the country together; its economy, if not reformed, could cause dangerous strain.

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MISREADING THE ELECTIONS

INDIA'S RECENT parliamentary elections aroused fears about its political viability, but not about its economy. The fractured verdict-40 parties won at least one seat, and no party won more than a third of the seats-created a hung parliament incapable of ending the political turmoil at India's center. While Sonia Gandhi stemmed the Congress Party's losses by assuming its leadership, the party that once provided India's stability continued its sclerotic decline. At the same time, the strong showing by the Hindu nationalist Bharatiya Janata Party (BJP), which was asked to form the new government, stirred fears that India would abandon its commitment to secularism in public life, setting the stage for sharper Hindu-Muslim conflict, political unrest, and perhaps heightened tension with Pakistan.

Economic issues, in contrast, stirred little alarm. They played practically no role in the elections, despite the current slump in India's economy and the meltdown in East Asia. Instead, most observers assumed that continued economic reforms, even at a slow pace, would keep India moving forward on the higher GDP growth path of six to seven percent attained in recent years.

The reality of India's prospects is just the opposite of these perceptions. The main threat to India's future is not political but economic. India's political system has for several years been in transition from Congress Party dominance to a more splintered picture in which regional and caste-based parties control most states, alongside a still unclear political pattern at the center. But neither the kaleidoscope of parties nor frequent changes of government nor the rise of the BJP as the preeminent national party should be mistaken for threats to India's underlying stability or its very unity. Rather, they are integral to the latest stage—a messy one, to be sure—of a social and political transformation made possible by democracy itself.

On the economic front, however, India's reforms are for all intents and purposes stalled, and its relatively poor recent performance—GDP was projected to increase by five percent at most in the 1997-98 fiscal year—is more than a passing business-cycle downturn. The unfinished half of the reforms—structural adjustments needed to lower fiscal deficits, improve financial markets, and create labor market flexibility—are nowhere in sight. During the tedious last two years, observers have consoled themselves over the slow pace with the view that the reform process is irreversible. But elements in the business community have soured on the reforms, no foreseeable government in New Delhi will have the strength to take on those who guard the status quo, and support for structural economic changes remains limited to narrow segments of the population.

A slower pace of reform and lower growth rates will not only cause economic pain but will also endanger India's social and political progress. Indian democracy is mobilizing heretofore sidelined classes and castes seeking both group recognition and material benefits. Regional differences in living standards and growth, a longstanding problem now exacerbated by the reforms, are creating new demands from laggard states. A failure to accelerate reform and growth would make the orderly accommodation of these interests, the reduction of poverty, and, eventually, the maintenance of democratic stability and national unity vastly more difficult.

DEMOCRATIC GLUE

THE WEST pays a great deal of lip service to India's democracy, but democracy is just as often blamed for the country's ills, especially the slow pace of economic progress, government ineffectiveness, social turmoil, and frequent challenges to national authority. More recently, the ascent of the BJP has led to fears that democracy could pave the way for an illiberal regime.

This is flatly wrong. India's democratic political system has been the ultimate source of the state's legitimacy, the major avenue of group mobility, and the main ingredient in the glue that has kept the country together. The leaders of India's independence movement are often accused of wrongly choosing democracy in 1947. In fact, they had little choice. Democracy was the only system that could possibly provide political cohesion in a society with little tradition of political centralism, dizzying social diversity, an independence movement built along participatory lines, and limited elections introduced only in the last three decades of British rule.

Today a vibrant, durable democracy is well established in India. India has had 12 general elections and many more state-level contests. Despite an electorate of over 600 million—each time an Indian general election is held, it is the largest organized human activity ever—elections have generally been free and fair. Despite illiteracy and daunting logistics, the average turnout in Indian parliamentary elections, including 1998, has been 57 percent of all adults, as compared to an average turnout of 56 percent of only registered voters in U.S. presidential elections since 1948.

Indian support for democracy was revealed in the largest ever national survey of political attitudes and behavior, conducted in 1996 by the Centre for the Study of Developing Societies (cs Ds) and India Today. Almost 70 percent of respondents said that governance is better because of parties and elections, up from 43 percent in a smaller but comparable 1971 survey. About 60 percent told the pollsters that voting made a difference, a conviction held disproportionately by poor people. Three-quarters dismissed the proposition that only the educated should have the right to vote. The very poor had a voting rate three percent higher than the national average.

Indian voters have repeatedly demonstrated their independence and sophistication. Since 1947, only a quarter of incumbents have been returned to power. Indeed, anti-incumbency was the only common denominator of the 1998 results. For instance, voters in ten states voted overwhelmingly against parties they had favored only two years ago. The Indian electorate also learned long ago to split its vote among different parties in elections for both state assemblies and the national parliament.

Governmental instability at the center is in fact partly a result of a healthy extension of democracy's reach. The ballot box has mobilized numerous linguistic, ethnic, and caste groups in the states, leading to the emergence of parties to represent them. Indian voters have been quite decisive in choosing among these and other parties at the state level. In the 1998 elections, for instance, voters in 13 of the 15 major states gave more than half of each state's parliamentary seats to one party or alliance. But because so many regional and caste-based parties are now contesting elections, the aggregation of these choices at the center produces fragmentation.

ACTUALLY, THE CENTER CAN HOLD

AMIDST THE much heightened competition in Indian politics today, the moderation embedded in Indian democracy remains a key source of underlying stability. This tendency is largely the result of the interplay of electoral politics and India's diversity. Because the electorate is so segmented by ethnicity, language, caste, and religion, politicians must build coalitions across parochial lines to gain power, which means in turn that they must avoid appeals that exclude or alienate.

The glue of these coalitions is usually only the desire to wield power or prevent others from acquiring it, which also helps explain India's wobbly governments. Once in office, the disparate coalition partners often have little to hold them together. The 1996-97 United Front government, whose constituent parts were united only by their desire to block the BJP, was easily toppled once Congress withdrew its support. Ironically, this syndrome may also be a problem for the new BJP-led alliance, which showed its fragility almost as soon as the election was over.

But over the longer term, democracy pushes all major political actors, even the BJP, toward moderation and power-sharing. Extremist and separatist appeals almost always wind up being repudiated at the ballot box. India's communists, for instance, moved toward the center and embraced the democratic process soon after independence to stay in the political game. In the Punjab, despite a decade of separatist violence and repression, voters strongly endorsed the moderate Sikh party once the political process was permitted to function.

India's diversity also means that few issues can effectively swing a broad geographic or political spectrum of Indian voters. Class-based politics, for instance, have had much less resonance than many expected in a country with such a gulf between rich and poor. Economic grievances are channeled through segmented social groups such as castes, keeping class in the European sense out of Indian

politics.

LIMITS OF HINDU NATIONALISM

THE 1998 GAINS by the BJP constitute an important turning point in Indian politics. At a minimum, Congress has been replaced as the dominant party in Delhi for the first time since independence. Some observers also see in the BJP'S Hindu nationalist ideology a dramatic and dangerous shift away from the values that have fostered India's "unity within diversity." But there is no need for panic. The BJP will be constrained by the centrist dynamic of Indian politics. The closer the BJP has gotten to power in recent years, the more it has learned that it must moderate or shed its extremist views if it hopes to seize it.

Voters punished the BJP in the 1993 state elections for its involvement in the destruction of the Babri mosque at Ayodhya in December 1992. From then on, the BJP retreated from the more aggressive version of its Hindu chauvinism. Even so, in the 1996 elections it failed to increase its share of the vote or to widen its geographic base. A postelection csDs-India Today survey helped explain the BJP'S poor showing: majorities of both Hindus and Muslims agreed that government should protect minorities' interests. So since 1996 the BJP has assiduously softened its Hindu chauvinism, including its promise to build a Hindu temple on the ruins of the Babri mosque. It also developed preelection alliances with regional and caste-based parties in states where it had little chance of gaining support itself

The BJP'S strategy paid off-but more through its alliances than through its own success at the polls. It increased its share of the vote in 1998 by only 5 percent, to 25 percent, to 25 percent, and its seat total by only 16. One reason for this modest gain was the surprising and sobering losses in two key states where the BJP and its allies ran state governments, Maharashtra and Rajasthan. The BJP's allies accounted for 72 seats, giving it the opportunity to form a government by enlisting support from still more regional parties through still more policy concessions.

The BJP took power, then, with a deeply compromised mandate, dependent on the support of almost 100 MPs from 17 other parties. It has already shelved some of its most controversial plans, such as revoking laws that protect distinctive Muslim marriage, divorce, and property practices. Furthermore, having appealed to voters as the party that could bring stable and effective government, the BJP must act cautiously if it is to both preserve its coalition and deliver on its promise. It is unlikely to antagonize Pakistan by curtailing Kashmir's autonomy or the United States by going openly nuclear.

These constraints are no guarantee that the BJP will pursue a moderate course or be able to hold a government together. There are serious ideological and programmatic differences within the party and between moderate figures like Prime Minister Atal Bihari Vajpayee, and the purist leaders of the Rashtriya Swayamsevak Sangh, the BJP's parent organization, to say nothing of its quarrels with its allies. And if the BJP fails, it will almost surely lose support next election.

ATTACKING CORRUPTION

THE GREATEST immediate threat to India's governance is not tottering coalition governments or the BJP but corruption. The combination of a state-run economy and weak political institutions created all too many opportunities for crooked politicians and bureaucrats. The resultant graft was exacerbated by the concentration of power at the center by Indira Gandhi, the former prime minister. Public trust in government has plummeted. In a recent survey, four of five respondents said the country had become corrupt, and only five percent described either politicians or the police as completely honest.

The problems are deep-seated, but India seems to have turned a corner in its public life. Spurred by public discontent, a process of political reform has begun that promises to reinvigorate both India's governing institutions and its citizens' confidence in them. Progress will be slow, but the country's political and governmental ills are being attacked on several fronts at once: electoral reform, corruption, intraparty democracy, and power-sharing between the center and the states.

The attack on corruption has been led by India's judiciary, including a Supreme Court that has rooted out graft at the highest levels. In recent years India's Election Commission, initially led by the maverick civil servant T. N. Seshan, has regulated campaign finance practices and forced political parties to hold more open leadership elections. The corruption issue was probably the most important reason for the Congress Party's electoral debacle in 1996, which sent a powerful message to other parties. Media muckraking has also been vital. For the first time in three decades, there is movement in the right direction.

Another salutary trend is the gradual but inexorable devolution of power from Delhi to state and local authorities. Coalition government at the center has given dramatic clout to regional parties. While state governments may be susceptible to populism and less experienced at policymaking, their increasing importance will bring longer-term benefits: a more open, accountable government and increasingly vigorous political competition at state and local levels, reinforcing both India's democratic process and its economic reforms.

LET'S STAY TOGETHER

THE ABSENCE of a strong party at the center and the growing power of regional parties and state governments have raised fresh doubts about India's ability to remain united. But India's nation-building record is strong. After 50 years, the country's international boundaries have not changed despite several secessionist threats, and the remaining challenges to national integrity are not especially daunting. By comparison, other new multiethnic states, such as Nigeria, Czechoslovakia, and Yugoslavia, have failed, and even older ones like Canada remain at risk.

Several factors explain India's success in forging a multinational state. First, democracy provided a highly effective alternative for disgruntled regions and groups to extremism and violence. Democratic politics let recently mobilized malcontents challenge the Indian state. When a group's demands were effectively accommodated, however, their stake in the political process led them to "buy in." In the mid1960s, for instance, Delhi drew back from an ill-advised effort to impose Hindi as the official language in the face of fierce resistance from the southern states, especially Tamil Nadu, thereby blunting rising Tamil nationalism. Under the control of regional parties ever since, that state has never had a serious recurrence of separatism, even after India refused to aid ethnic Tamils in neighboring Sri Lanka's civil war.



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Militants no more?: The BJP's Vajpayee and Advani,
February 1993 [z/tanzs [Dv]

A second factor is the dynamism of India's federalism. No mere formal division of powers, India's federal system encourages negotiation, compromise, and cooperation. This has been particularly evident in the northeast, where Delhi has sought to accommodate demands for autonomy and co-opt ethnic movements amidst rising violence.

The Indian state, on balance, responds well to separatist crises. In the 1960s, Gunnar Myrdal worried that as a "soft state" India would not be able to manage decisively. Certainly there have been mistakes in India's first half-century of nation-building-the festering Kashmir situation is a result, in part, of such misjudgments-but the government's ability to effectively bring its coercive, administrative, and developmental resources to bear has been amply demonstrated in Punjab and the northeast.

TIGER OR ELEPHANT?

ALL THIS is the good news. The bad is that India's economic reforms are at a crossroads. Although long overdue, the reform process initiated in 1991 brought far-reaching change to India's creaky, largely statecontrolled economy in just four years. The removal of the "license raj" system that stifled domestic businesses and the reduction of taxes and tariffs, as well as a new openness to foreign investment, generated rapid growth. India's economy, which had lumbered along at 3.5 percent growth per year from 1950 to 1980, picked up to 5.5 percent in the 1980s and averaged 7 percent growth in fiscal years 1995 to 1997. Some claimed that India had joined the ranks of Asia's tiger economies.

Last year, however, India looked more like an elephant again. Industrial growth in the first three quarters of fiscal year 1998 was half that of the same period the previous year and a third of its peak between 1994 and 1996. Agriculture, which had been a star performer in the previous fiscal year, is expected to have negative growth in 1997-98. Exports increased only 4 percent during 1997, compared with an average of 20 percent from 1994 to 1996. One of the few bright spots was the continued influx of foreign direct investment-up 52 percent in the first n months of 1997 over the same period in 1996 despite the mixed signals India continues to send foreign investors. In February 1998, Delhi revised its estimate of GDP growth for 1997-98 from 7 to 5 percent, and some economists thought this optimistic.

India's current economic slump has many of the hallmarks of a business-cycle downturn: excess capacity, drooping demand, and weak investor and consumer confidence. The rapid growth of 1993-96 generated high levels of investment and capacity, especially by India's previous standards. In late 1995, the government, worried about inflation before the 1996 elections, began squeezing liquidity and curtailing public investment. Retail investors, scared away by the stock market scams and disappointments of the boom, put their spare cash into bank savings and gold instead. Growth slowed, leading to overcapacity in many industries and cuts in business expenses and investment. Delhi's political instability after June 1996 depressed confidence further. Despite the government's lowering of interest rates and other credit relaxation measures in late 1996, the slowdown continued through 1997.

UNFINISHED BUSINESS

INDIA'S BUSINESS-CYCLE downturn is in one sense heartening: the liberalizing reforms of the last seven years have opened the economy to market forces and thus to boom and bust. Alas, India is unlikely to resume the growth of seven to eight percent a year it needs over the long term without further liberalization and structural adjustments. Like Mexico and others, India faces the quandary of a half-completed reform process: the forces unleashed by the first phase of change are driving it toward further reform, but the obstacles and pain of the next phase are greater still.

Even so, further reform is critical for several reasons. First, India's financial sector still cannot effectively mobilize and mediate capital to respond to economic changes. The resulting high cost of capital makes Indian industry and exports less competitive. Although much improved since 1991, India's equity markets are still too thin and volatile to inspire great confidence on the part of domestic or foreign investors. Bond markets are practically nonexistent. Liberalization of the insurance industry, which would greatly improve the investing of India's substantial savings, now 26 percent of GDP, has been stymied. India's banking system remains flawed, with the dominant state-owned banks still carrying bad loans amounting to 15 to 25 percent of their total.

Second, India's abysmal infrastructure is a major constraint on growth. Part of the problem is that financing has been difficult. Ambitious plans to improve power generation, telecommunications, ports, and roads have also been thwarted by poor policies, indecision, and corruption. Of eight so-called fast-track power projects initiated in 1992, only two are producing or are close to producing power. Telecommunications reforms were mired first in massive graft and then in battles over regulation; unsurprisingly, many major foreign companies retreated.

Third, Indian trade has been opened enough to expose many companies to greater competition but not enough to provide a strong, sustained impetus for growth. Bankruptcies and near-bankruptcies of noncompetitive Indian companies are on the rise. At the same time, healthy Indian companies that could lower their production costs with cheaper imported goods saw Delhi raise tariffs by three percent in 1997. Export growth might have been a useful counterweight to economic sluggishness at home, but excessive import tariffs, high transaction costs due to bureaucratic inefficiency and corruption, infrastructure bottlenecks, and an appreciating rupee made Indian exports too expensive.

Fourth, uncertainty about Indian macroeconomic policy worries investors and managers. Business plans in India have generally been held hostage to unpredictable cycles of inflation caused by government spending, followed by liquidity squeezes to contain it. Delhi has not yet taken the steps that would break the resulting long-term inflation expectations of investors. It reduced the fiscal deficit from a high of almost ten percent of GDP in the early 1990s to about half that by last year. Much of this progress has been achieved, however, by increasing revenues rather than by reducing government expenditures. Subsidies, which primarily benefit middle-class farmers and cost 15 percent of GDP, have generally not been reduced. Support for public-sector enterprises, most of which lose money, has been cut but remains a major drain on government funds. Government salaries were hiked in 1997, a move that may eventually cost as much as five percent of GDP a year without reducing the size of government. As a result, the 1997-98 deficit is likely to be well above five percent of GDP.

Fifth, India needs greater labor market flexibility to make its companies more competitive and its economy more productive. Politically powerful labor unions have stifled most efforts at serious reform or privatization of India's largest public sector enterprises, including most banks, all insurance

companies, and many major industries even though privatization would probably cost the jobs of no more than 1.1 percent of the urban labor market. India's labor laws hinder efficiency and growth.

Finally, foreign investment in India, while much increased in recent years, remains far too low. Foreign direct investment approvals have soared since reform began, from 5.3 billion rupees in 1991 to 361 billion in 1996, but the cumulative actual flows have been only one-fifth of the amount approved. In contrast, approved FDI to China has been eight to ten times India's in recent years, and actual flows as a percentage of approvals have been twice India's.

This FDI performance has not even met Delhi's goals—a disappointment born of bureaucratic delays, unclear regulations, and investors' fears of inconstancy from the central government. In the past year, a number of high-profile disputes, including a spat between the Indian government and Suzuki over management of their joint automotive venture, have further diminished investor confidence. And now foreign business leaders will be watching closely to see whether a BJP-led government will keep its promise to implement more restrictive policies on outside investment.

ORPHANED REFORMS

THE REFORM agenda faces growing resistance from both right and left. Powerful Indian industries are now feeling the competitive heat and looking for cover, including anti-takeover legislation, a slowdown of tariff reductions, and aggressive antidumping measures. Both the BJP and Congress have said that they favor protecting Indian businesses for at least five years. Meanwhile, the left will continue to defend fiercely its organized labor base, to which the BJP owes little.

Economic nationalism may be regaining its respectability. The combination of the BJP's ascendancy and the lessons of East Asia's economic crisis has given new currency to Indian protectionism, from delaying capital account convertibility to increasing restrictions on foreign investment to slowing tariff reductions. After the election, one BJP leader said India had to liberalize and modernize before it could globalize. A BJP government would no doubt try to be pragmatic on these issues, at least at first; Vajpayee wants foreign investment in some sectors and is loath to renege on India's World Trade Organization commitments. But chauvinist ideology and responsible government are difficult to reconcile.

Political instability and gridlock in Delhi may frustrate restructuring, as they have in Japan. A BJP dependent on more than a dozen parties for its political survival will find it hard to enact even those reforms it favors. Populism remains a staple of state-level politics, and many of the regional and caste-based parties with which the BJP may ally will be wary of policies affecting such key constituencies as civil servants or farmers. Given the current fragmented state of India's national politics, this would be a problem even if Congress and the United Front were to form a government.

So the political base for reform remains narrow. The only significant constituency for reform is the urban middle class, which is at most a quarter of the electorate. By contrast, almost 60 percent of India's electorate is from the rural lower castes, and only a handful of these voters have even heard of the reforms. But the next stage of the reform process, which will create many more losers—notably public sector employees and subsidy recipients—will require a broader base of support than the first stage.

The international environment for reform may be worsening. True, India has been spared the worst of the East Asian troubles because of its lower dependence on exports, healthier current account balance,

modest short-term debt, and the limited convertibility of the rupee. But the danger has not yet passed. Currency depreciations in East Asia are forcing the prices of tradable goods down, further threatening Indian producers and fanning protectionist sentiment. If the new government reverses course and lets the rupee depreciate, it will have to deal with higher inflation, especially if it also chooses to prime the pump with increased government spending. Direct investment from East Asia will suffer, and more cautious portfolio investors may shy away from India. REMEMBER THE POOR OVER COMING THE obstacles to further economic reform will be a long and challenging process. Few observers in 1991 would have predicted that India would come as far as it has. But until now, Indian leaders have generally followed a "reform by stealth" strategy to avoid arousing opposition. This is neither desirable nor possible in the next phase. To build support for restructuring, Indian leaders will need to broaden the reforms and sell them to India's people.

The reforms must be seen to benefit India's huge rural, lower-caste population. Without their support, agricultural subsidies cannot be reduced or eventually eliminated. In the end, the most important constituency for the reforms is the rural poor, whose increasing political participation and rising economic expectations must be accommodated to maintain political stability

The next phase of reform must therefore give greater attention to improving agriculture, which grew at an annual average of only 3.6 percent from 1951 to 1997 despite a series of favorable monsoon seasons. Higher growth and incomes can be attained relatively simply by deregulation and by investing in rural infrastructure. Social spending must also increase. Improvements in health, education, the water supply, and sanitation will have both immediate and long-term payoffs. While public investment here has been growing, it could increase dramatically if other government expenditures were brought under control. Finally, widening economic disparities between India's regions and states, particularly the fast-growing west and south and the slow-growing east and north, could become a ticking time bomb. Market-friendly measures to narrow these gaps without cutting off growth could pay major dividends in support for reform.

As India approaches the close of its 50th year of independence, it has, by any reasonable standard, done quite well at nation-building. The two most important objectives of Gandhi and Nehru in August 1947—political viability and national integrity—have been met. The recent political and economic reforms will, if successful, strengthen the Indian body politic and improve the living standards of close to a billion citizens. Achieving these goals will require a degree of vision and courage from today's leaders even greater than that of India's founders.

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